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SUBJECT: TURKEY'S BTC PIPELINE AIMING AT FIRST OIL AT
CEYHAN SEPTEMBER 2005

11. (SBU) Summary: According to the BTC Consortium's Turkey office, the Baku-Tbilisi-Ceyhan (BTC) oil pipeline is 95 percent complete in Turkey. After testing and line fill, the first tanker will be loaded at Ceyhan port by September 2005.

Given construction delays and problems with the subcontractors in the Lot A segment near the border with Georgia, the prime contractor, state pipeline firm BOTAS, has taken over control of construction completion. End Summary.

Lot A Woes Overcome - Inshallah

12. (SBU) Reinforcing statements by senior BP officials to Ambassador in December, BTC Turkey Director Yashar Latifov confirmed that construction problems in Lot A) adjacent to Georgia) required BOTAS to take over completion of the project from its Lot A subcontractor joint venture: Turkish TEPE and Dutch Nacap. In a January 7 meeting, Latifov expressed confidence that BOTAS -with the oversight of project lead BP - will bring the project to completion substantially on time. While the entire 1000 kilometer project in Turkey was 95 percent complete, he noted that Lot A was about 86 percent complete with about 70 kilometers of welded pipe still above ground. He candidly noted that inadequate performance by the sub-contractors, fueled partly by disagreement between themselves and financial problems at TEPE, had reached an unacceptable level that had threatened timely construction completion. All parties supported the overall contractor BOTAS taking over responsibility for completion. BOTAS also took over completion of two pump stations from TEPE. Despite snow and extreme cold in Turkey's high elevation east, Latifov said construction crews have been mobilized and are able to maintain progress.

13. (SBU) Latifov asserted that the pipeline in Turkey would be complete by the end of April 2005 (Ministry of Energy Pipelines Department Head Nilgun Acikalin made the same estimate on January 6.) The BTC Director said that the project's upstream work was on schedule and first oil would be pumped at the wellhead in Azerbaijan in February and delivered to the Baku import terminal in March. Line-fill would proceed in March and April in Azerbaijan and Georgia, respectively. According to Latifov, by the end of first half 2005, all testing would be complete in Turkey and the pipeline would be ready for introduction of hydrocarbons at the Georgia border. Filling of the pipeline would proceed over the next 2-3 months) five million barrels of oil, so then the first tanker would fill with BTC oil at Ceyhan in September.

Lessons Learned

14. (SBU) In briefly reviewing the project history, Latifov noted the lessons learned for all parties. The linchpin of the deal was provision of the \$1.4 billion fixed price, turnkey contract from the Government of Turkey (GOT), in advance of detailed engineering and even route designation. Over 2001 to 2002, the detailed engineering, procurement, environmental assessment, and route/land survey indicated that the \$1.4 billion cap was aggressive, but feasible. Because of the unusual GOT guarantee, the state sought to maintain project and procurement control through BOTAS functioning as general contractor. Because BOTAS lacked the technical expertise, experience, and depth to execute the entire project in Turkey, the project was divided into three lots granted to sub-contractors, most functioning as joint-venture groups. With the new GOT government in early 2003, BOTAS was slow in getting the project fired up. With the attention of project sponsors and the USG, BOTAS overcame this hurdle, and construction has generally been substantially on track. Latifov noted a number of key lessons:

-Some of the sub-contractors lacked adequate technical experience (i.e., TEPE exhibited only adequate civil construction track-record, but failed to even erect good construction camps). Latifov suggested that inadequate attention to subcontractor financial wherewithal and/or

under-bidding contributed to the ultimate problems.

-BOTAS gained incredible general contractor experience, heretofore lacking. Obtaining a lump sum turnkey contract before engineering is a unique experience.

-The special role of the international financial institutions contributed to overall three-country cost overruns of up to \$400 million on the \$2.9 billion project (also reported widely in the press). Financing, due diligence, and consulting costs were unexpectedly burdensome, in Latifov's opinion.

-Latifov noted that the project was to be built to BP and international standards (the highest common denominator), but in effect BOTAS expected to utilize standards required by Turkish law (the lowest common denominator). BOTAS has argued that BP intercessions to require high standards should be treated as change of scope requirements. These arguments will continue to play out in assigning responsibility for construction delays and cost overruns, but, unlike in Georgia, have not delayed construction in Turkey.

-The pipeline fill will be about twice as costly as projected, given current oil prices.

15. (SBU) Latifov noted that construction was the relatively easy part; now the project had to be managed successfully over the forty year project life, again testing BOTAS, expertise and experience. Moreover, the governments involved had to assure security and an appropriate operating environment. Latifov observed that the lessons learned would be valuable for the next big project: the Shah Deniz gas pipeline, which would generally parallel BTC, including about 200 kilometers in Turkey to Erzurum. The Director said that construction had started in Azerbaijan and public tenders had been advertised one month ago. He expected major construction to start this summer to allow projected gas flow at the end of 2006.

16. (SBU) COMMENT: It is not surprising that such a large and unique international project would have some unexpected challenges, delays, and cost overruns. BTC's Turkey Office's characterization of construction and oil flow timing appear credible to us, although we are not in a position to directly eyeball the final construction zone. We also are not in a position to evaluate both BTC and our Ministry of Energy contacts' suggestions that some construction and security issues remain in Georgia.

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